



## CONGRESSIONAL BUDGET OFFICE PAY-AS-YOU-GO ESTIMATE

October 28, 1997

### **Public Law 105-61** **Treasury and General Government Appropriations Act, 1998**

*As cleared by the Congress on October 1, 1997*

#### **SUMMARY**

The Treasury and General Government Appropriations Act for fiscal year 1998 includes a provision that would provide an open season for federal employees covered by the Civil Service Retirement System (CSRS) to switch into the Federal Employees' Retirement System (FERS). Under this provision, the open season would run from July 1, 1998, to December 31, 1998.

CBO estimates that, if this provision takes effect, federal agencies would bear costs totaling \$660 million over the next ten years for additional contributions to retirement trust funds and to the Thrift Savings Plan (TSP) for federal employees. These costs would be paid out of agency appropriations and would be subject to limits in law on aggregate discretionary appropriations. We estimate that the open season provision would reduce direct spending by \$434 million over the 1998-2007 period primarily because of increased agency retirement contributions to the Civil Service and Social Security trust funds, which would be reflected in the budget as an increase in offsetting receipts. Finally, we estimate that increased participation in the TSP would reduce revenues by \$25 million over the same period.

CBO believes that the effects of this provision on the pay-as-you-go scorecard should be limited to the changes in on-budget revenues. CBO estimates that such revenues would decline by \$151 million over the 1998-2002 period and by \$312 million over the 1998-2007 period.

## **ESTIMATED COST TO THE FEDERAL GOVERNMENT**

Table 1 displays CBO's estimate of the budgetary effects of the retirement provision of Public Law 105-61 through fiscal year 2007. Including discretionary appropriations, we project that this provision would have a net cost of \$251 million over the next 10 years.

### **BASIS OF ESTIMATE**

#### **Number of Employees Switching**

CSRS employees had a previous opportunity to switch to FERS during a six-month open season in 1987. About 86,000 employees—4.1 percent of all eligible employees—switched to FERS during this first open season. CBO estimates that approximately 11,500 people—fewer than one percent of all CSRS employees—would take advantage of this new opportunity to switch to FERS. This estimate is substantially lower than the 1987 figure for three reasons. First, it reflects the assumption that those CSRS employees who were most likely to switch to FERS did so in 1987. CBO assumed that "switch rates" in each year of service category (15 to 19 years, 20 to 24 years, etc.) for the 1998 open season would be half of the 1987 rates. Second, CSRS employees now typically have at least 14 years of service, and switch rates in 1987 were highest for CSRS employees with fewer than 10 years of service. Finally, the total number of CSRS employees, including Postal Service employees, is much lower now than in 1987 (1.2 million compared to 2.1 million).

The 1998 open season would extend from the last quarter of fiscal year 1998 to the first quarter of fiscal year 1999. CBO assumed that employees would apply to switch at a uniform rate—that is, about 2,000 applications would be submitted each month. In 1987 an employee's switch to FERS became effective in the first pay period after his application to switch was received; CBO assumed that applications for the 1998 open season will be processed similarly. Thus the transfers would occur roughly equally in fiscal years 1998 and 1999, and fiscal year 2000 would be the first full year under FERS for all of the switching employees.

#### **Effects on Discretionary Spending**

**Increased Employer Contributions.** CBO estimated the aggregate salary base for switching employees by multiplying the number of people switching in each service category by the average salary for CSRS employees in that category. Agency retirement contributions for most employee groups are currently 8.51 percent of employee pay for CSRS workers and 10.7 percent for FERS employees. Employing agencies would thus have to contribute an additional 2.2 percent of employee pay for workers who switch to FERS. This amount

TABLE 1. BUDGETARY EFFECTS OF NEW OPEN SEASON PROVISION IN PUBLIC LAW 105-61  
(By fiscal year, in millions of dollars)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
<b>Spending Subject to Appropriations (Outlays)</b>										
Agency Retirement Contributions	6	44	47	48	48	55	49	46	43	42
Agency Thrift Savings Plan Contributions	3	26	28	28	28	28	25	23	22	21
Total Discretionary Outlays	9	70	75	75	76	83	74	69	65	64
<b>Direct Spending (Outlays)</b>										
<u>On-Budget</u>										
Agency Contributions (non-Postal)	-1	-10	-11	-11	-11	-18	-16	-15	-14	-14
Agency Contributions (Postal)	0	-2	-3	-3	-3	-3	-2	-2	-2	-2
FERS Pension Payments	0	0	0	0	0	0	4	6	8	10
CSRS Pension Payments	0	0	0	0	0	-1	-7	-13	-18	-21
Subtotal	-2	-12	-13	-13	-14	-21	-22	-24	-26	-27
<u>Off-Budget</u>										
Agency Payments to Social Security										
Non-Postal	-4	-28	-30	-30	-30	-30	-27	-25	-24	-23
Postal	-1	-4	-4	-4	-4	-4	-4	-4	-4	-4
Social Security Benefits	0	0	0	0	0	0	4	6	7	8
Subtotal	-4	-32	-34	-34	-35	-35	-27	-23	-20	-18
Total Direct Spending Outlays	-6	-44	-47	-48	-48	-55	-49	-47	-45	-45
<b>Revenues</b>										
<u>On-Budget</u>										
Income Tax Payments by Employees	0	-3	-3	-3	-3	-3	-3	-3	-2	-2
Employee Contributions to Retirement	-4	-32	-34	-34	-35	-35	-31	-29	-27	-26
<u>Off-Budget</u>										
Social Security Taxes Paid by Employees	4	32	34	34	35	35	31	29	27	26
Total Revenues	0	-3	-3	-3	-3	-3	-3	-3	-2	-2
<b>Net Deficit Effect</b>										
Increase or Decrease ( - ) in Deficit from:										
Direct Spending and Revenues	-5	-41	-44	-45	-45	-52	-46	-44	-43	-43
All Spending and Revenues	4	29	31	31	31	31	28	25	22	21

Note: Components may not sum to totals because of rounding.

would rise to 3.7 percent in calendar year 2003 because employer contributions for most CSRS workers will decrease to 7.0 percent under provisions in the Balanced Budget Act of 1997. Thus, the increase in agencies' retirement contributions was calculated as 2.2 percent of the aggregate salary base through calendar year 2002 and 3.7 percent thereafter, totaling an estimated \$141 million over 10 years.

In addition to the increase in contributions to the retirement trust fund, agencies would also have to pay 6.2 percent of the salaries of the new FERS enrollees (up to the \$68,400 maximum taxable salary) to the Social Security trust fund. CBO estimates that these payments would total \$287 million over the 1998-2007 period.

**Increased TSP Contributions.** CSRS workers may wish to switch to FERS in order to expand their participation in the Thrift Savings Plan. CSRS employees currently do not receive government matching funds on their TSP contributions and cannot contribute more than 5 percent of their pay. CBO assumed that TSP contributions for switching employees would rise from 4 percent (the current average for CSRS employees who participate in TSP) to 7 percent. Although employee contributions to TSP are not reflected in the federal budget, the switching employees would become eligible for the full 5 percent government match. CBO estimates that the government's outlays for these additional matching payments, calculated as 5 percent of the aggregate salary base for switching employees, would total \$232 million over 10 years.

Including contributions to the Civil Service retirement fund, the Social Security trust fund, and the Thrift Savings Plan, the bill would increase federal agencies' costs on behalf of each employee who switched to FERS by more than 13 percent of the employee's salary, or an average of about \$6,500 per employee in 2000. In total, agencies' costs for these employees would increase by \$9 million in fiscal year 1998 and \$660 million over the 1998-2007 period. Such outlays are classified as discretionary spending, which is capped through 2002 by the Balanced Budget Act of 1997. Under these caps, agencies would be required to cut back on their personnel or other spending in order to pay for the increased costs for employees switching to FERS.

## **Effects on Direct Spending and Revenues**

**Receipts to Trust Funds.** The increases in agency contributions—other than to TSP—would be reflected in the budget both as additional agency outlays and as offsetting receipts to the trust funds. Thus, receipts to the Civil Service trust fund would increase by \$141 million over 10 years, and receipts to the Social Security trust fund would increase by \$287 million over that period.

**FERS and CSRS Pension Payments.** CBO's estimate assumes that few of the employees switching to FERS would retire within the next five years. This assumption is based on two factors: (a) few of the employees switching would have more than 30 years of service, and (b) employees switching to FERS to avoid the Social Security government pension offset must first work at least five years under FERS. CBO assumed that switching workers would begin to retire at the very end of fiscal year 2003, with the first substantial pension payments taking place in 2004. The government's outlays for FERS benefits for switching workers would be less—by an estimated \$32 million through 2007—than the reduction in payments for CSRS benefits. This savings reflects the differing accrual rates for annuity payments under CSRS (2 percent per year) and FERS (1 percent per year).

**Social Security Benefits.** Employees who switch to FERS and work at least five years under that system will not be affected by Social Security's government pension offset and may receive a spousal benefit. In addition, workers may also be eligible for survivor benefits. CBO assumed that retiring workers would receive an average Social Security benefit of approximately \$250 a month beginning in fiscal year 2004.

**Revenue Loss.** Income used for TSP contributions is exempt from income tax. The 3 percentage point increase in TSP contributions for switching employees would thus lower taxable income and revenue. CBO estimated the additional amount exempt from income tax as 3 percent of the aggregate salary base, and the corresponding revenue loss as 19 percent of that amount, or \$25 million over ten years.

**Shift in Employee Contributions.** CSRS employees switching to FERS would contribute 7.0 percent of their pay towards retirement on earnings up to the Social Security maximum wage level—\$68,400 in 1998—and 0.8 percent on earnings above that level. These are the same percentages they would contribute under CSRS for salaries up to \$68,400. But, under FERS, 6.2 percentage points (of the 7.0) would go to the Social Security trust fund instead of the Civil Service trust fund. This change would shift revenues from one fund to the other but would have no significant net budgetary impact.

## **PAY-AS-YOU-GO CONSIDERATIONS**

Under the procedures established by the Balanced Budget and Emergency Deficit Control Act of 1985, changes in on-budget direct spending caused by provisions in appropriation bills are effectively counted as increases or decreases in discretionary spending for purposes of determining compliance with the discretionary caps. For the current year and the budget year, such changes are added to the estimated discretionary budget authority and outlays attributed to the appropriation bill. For subsequent years, they are reflected on the discretionary side of the budget by adjusting the caps.

Changes in revenues, however, are not counted in determining compliance with the discretionary caps. Therefore, CBO believes that the on-budget revenue impacts of appropriation bills should be recorded on the pay-as-you-go scorecard.

The following table summarizes the on-budget revenue effects of the retirement provision in Public Law 105-61. Those effects include (1) the loss of income tax revenue resulting from the increase in employees' contributions to the TSP, and (2) the loss of on-budget revenue resulting from the switch of 6.2 percentage points of employees' contributions from the Civil Service trust fund to the off-budget Social Security trust fund. These two changes produce an estimated loss of on-budget revenues totaling \$312 million over the 1998-2007 period, as shown in the table below. For purposes of enforcing pay-as-you-go procedures, only the effects in the budget year and the succeeding four years are counted.

Table 2. Summary of Pay-As-You-Go Effects

	By Fiscal Year, in Millions of Dollars									
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Change in Outlays	0	0	0	0	0	0	0	0	0	0
Change in Receipts	-4	-35	-37	-37	-38	-38	-34	-32	-29	-28

The estimate of pay-as-you-go effects does not include discretionary outlays or off-budget revenues or outlays, which are not governed by the pay-as-you-go process. Thus, agency contributions from appropriated funds and Social Security revenues and benefit payments are excluded from this calculation.

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